

Report  
of the  
Examination of  
1<sup>st</sup> Auto & Casualty Insurance Company  
Madison, Wisconsin  
As of December 31, 2002

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# State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

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*Jorge Gomez, Commissioner*

*Wisconsin.gov*

January 26, 2004

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Honorable Jorge Gomez  
Commissioner of Insurance  
State of Wisconsin  
125 South Webster Street  
Madison, Wisconsin 53702

Commissioner:

In accordance with your instructions, a compliance examination has been made of  
the affairs and financial condition of:

1ST AUTO & CASUALTY INSURANCE COMPANY  
MADISON, WISCONSIN

and this report is respectfully submitted.

## I. INTRODUCTION

The previous examination of 1<sup>st</sup> Auto & Casualty Insurance Company ("1<sup>st</sup> Auto," or  
"the company") was conducted in 1999, as of December 31, 1998. The current examination  
covered the intervening period ending December 31, 2002, and included a review of such 2003  
transactions as deemed necessary to complete the examination.

The examination consisted of a review of all major phases of the company's  
operations, and included the following areas:

- History
- Management and Control
- Corporate Records
- Conflict of Interest
- Fidelity Bonds and Other Insurance
- Employees' Welfare and Pension Plans
- Territory and Plan of Operations
- Affiliated Companies
- Growth of Company
- Reinsurance
- Financial Statements
- Accounts and Records
- Data Processing

Emphasis was placed on the audit of those areas of the company's operations accorded a high priority by the examiner-in-charge when planning the examination. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The section of this report titled "Summary of Examination Results" contains comments and elaboration on those areas where adverse findings were noted or where unusual situations existed. Comments on the remaining areas of the company's operations are contained in the examination work papers.

The company is annually audited by an independent public accounting firm as prescribed by s. Ins 50.05, Wis. Adm. Code. An integral part of this compliance examination was the review of the independent accountant's work papers. Based on the results of the review of these work papers, alternative or additional examination steps deemed necessary for the completion of this examination were performed. The examination work papers contain documentation with respect to the alternative or additional examination steps performed during the course of the examination.

#### **Independent Actuary's Review**

Independent actuaries were engaged under a contract with the Office of the Commissioner of Insurance. They reviewed the adequacy of the company's loss reserves and loss adjustment expense reserves. The results of their work were reported to the examiner-in-charge. As deemed appropriate, reference is made in this report to the actuaries' conclusion.

## II. HISTORY AND PLAN OF OPERATION

The company was organized in 1991 as 1<sup>st</sup> Auto & Casualty Insurance Company, and commenced business on September 21, 1991. The company is a wholly owned insurance subsidiary of Wisconsin Reinsurance Corporation ("WRC"), a Wisconsin domiciled property and casualty insurance company. 1<sup>st</sup> Auto was initially capitalized with \$500 paid-in capital and \$2,999,500 paid-in surplus. WRC contributed \$2 million of additional capital in 1997.

1<sup>st</sup> Auto does not have any employees, and all operating functions of the company are performed by WRC pursuant to intercompany services agreements. 1<sup>st</sup> Auto business operations conducted by WRC include insurance underwriting, marketing and policy issuance, reinsurance administration and accounting, claims administration and adjudication, and accounting and financial reporting. Further discussion of the WRC holding company organization, description of the significant affiliates of the company, and description of the company's affiliated agreements is included in the section of this report captioned "Affiliated Companies."

The company is licensed in Wisconsin, South Dakota, Arkansas, and Iowa, and had the following direct written premiums during 2002:

Wisconsin	\$18,332,945	81.6%
South Dakota	2,809,221	12.5%
Arkansas	1,317,300	5.9%
Iowa	<u>14,564</u>	<u>-0-</u> %
Total	<u>\$22,474,030</u>	<u>100.0%</u>

At the time that examination fieldwork was conducted, the company had the following distribution of insurance in force by state:

Wisconsin	\$175,516,850	81.8%
South Dakota	23,867,176	11.1%
Arkansas	10,542,376	4.9%
Iowa	<u>4,748,389</u>	<u>2.2%</u>
Total	<u>\$214,674,791</u>	<u>100.0%</u>

The major products marketed by the company are private passenger automobile property and liability insurance coverages. Company underwriting restrictions in Wisconsin limit new business production to policies issued in conjunction with existing property insurance policies written on a direct basis by WRC client mutual insurance companies. 1<sup>st</sup> Auto also sells a small

volume of commercial auto, personal umbrella liability, and worker's compensation business.

Workers compensation policies are written solely in Wisconsin, and personal and farm liability are written solely in Iowa. Farm and personal umbrella risks are written in South Dakota and in Wisconsin. The company writes private passenger automobile property and liability risks in Arkansas. The company's policies are marketed by approximately 900 independent agents who are both independent and captive agents of mutual insurance company clients of WRC.

The following table is a summary of the net insurance premiums written by the company in 2002. The growth of the company is discussed in the Financial Data section of this report.

<b>Line of Business</b>	<b>Direct Premium</b>	<b>Reinsurance Assumed</b>	<b>Reinsurance Ceded</b>	<b>Net Premium</b>
Farmowners multiple peril	\$ 2,387	\$0	\$ 2,387	\$ 0
Homeowners multiple peril	3,704	0	3,704	0
Workers' compensation	207,001	0	76,728	130,273
Other liability - occurrence	592,092	0	551,352	40,740
Private passenger auto liability	10,765,362	0	1,549,583	9,215,779
Commercial auto liability	194,056	0	27,934	166,122
Auto physical damage	<u>10,709,428</u>	<u>0</u>	<u>675,466</u>	<u>10,033,962</u>
Total All Lines	<u>\$22,474,030</u>	<u>\$0</u>	<u>\$2,887,154</u>	<u>\$19,586,876</u>

### III. MANAGEMENT AND CONTROL

#### Board of Directors

The 1<sup>st</sup> Auto & Casualty Insurance Company board of directors consists of five members. Each 1<sup>st</sup> Auto director is elected annually to serve a one-year term. Company officers are elected at the board's annual meeting. Each member of the 1<sup>st</sup> Auto board of directors is a senior executive of the company's parent, Wisconsin Reinsurance Corporation. 1<sup>st</sup> Auto's board members are not paid specific remuneration as compensation for serving on the company's board of directors.

Currently the board of directors consists of the following persons:

<b>Name and Residence</b>	<b>Principal Occupation</b>	<b>Term Expires</b>
Terry H. Wendorff Sun Prairie, WI	President and Chief Executive Officer Wisconsin Reinsurance Corporation	2004
Cathleen R. Kazmierczak Lodi, WI	Senior VP of Internal Operations Wisconsin Reinsurance Corporation	2004
Peggy L. Mickelson Columbus, WI	VP of Administration, Assistant Secretary Wisconsin Reinsurance Corporation	2004
Larry E. Moe Madison, WI	Senior VP of Reinsurance Operations Wisconsin Reinsurance Corporation	2004
Todd J. Lentz Pardeeville, WI	VP of Finance, Assistant Treasurer Wisconsin Reinsurance Corporation	2004



## Officers of the Company

The officers serving at the time of this examination are as follows

<b>Name</b>	<b>Office</b>	
Terry H. Wendorff	President	\$15,754 *
Peggy L. Mickelson	Secretary	32,378 *
Todd J. Lentz	Treasurer	6,766 *
Cathleen R. Kazmierczak	Chief Executive Officer	75,209 *

\* Each officer of 1<sup>st</sup> Auto is an employee of WRC, and WRC remits all annual compensation paid to the individuals who serve as 1<sup>st</sup> Auto officers. A portion of the annual compensation paid by WRC to its employees, including the officers of 1<sup>st</sup> Auto, is allocated to WRC subsidiary companies pursuant to affiliated services agreements. Allocations are based on analysis of the proportion of an individual's work responsibilities that pertain to the various affiliates. The compensation data reported above reflects the portion of WRC compensation paid to the respective 1<sup>st</sup> Auto officers that was allocated to 1<sup>st</sup> Auto. The WRC allocation percentages for the 1<sup>st</sup> Auto officers range from 9% to 80%.

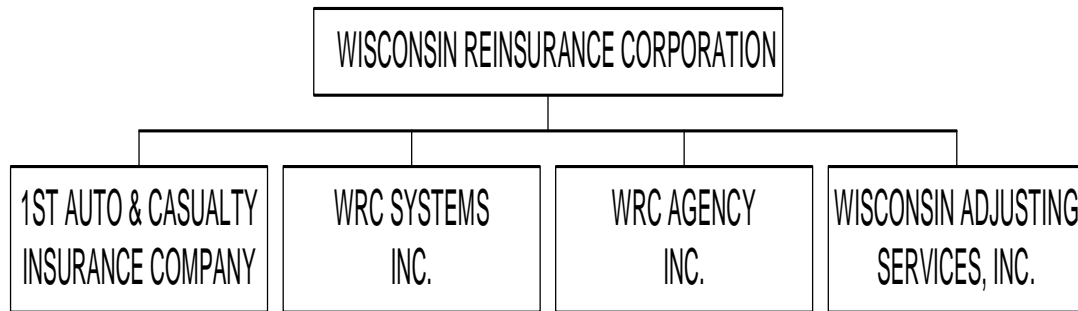
## Committees of the Board

The company's bylaws allow for the formation of certain committees by the board of directors. As of the time of the current examination the company had not established any committees of the board of directors.

#### IV. AFFILIATED COMPANIES

1<sup>st</sup> Auto & Casualty Insurance Company is a member of the Wisconsin Reinsurance Corporation holding company system. The organizational chart below depicts the organizational relationships among the affiliates in the group. A brief description of the significant affiliates and significant agreements among affiliates follows the organizational chart.

**Organizational Chart  
As of December 31, 2002**



##### **Wisconsin Reinsurance Corporation (“WRC”)**

Wisconsin Reinsurance Corporation is a Wisconsin domiciled stock property and casualty insurance company. WRC provides a variety of reinsurance products to small mutual insurers in Wisconsin, South Dakota, Arkansas, and Iowa. As of December 31, 2002, the statutory basis audited financial statements of WRC reported total admitted assets of \$42,115,767, total liabilities of \$24,032,518, and capital and surplus of \$18,083,247. WRC operations for 2002 resulted in net income of \$1,089,204. WRC is the subject of a separate examination report concurrent with that of 1<sup>st</sup> Auto.

##### **WRC Systems, Inc.**

WRC Systems, Inc., provides computer hardware, computer software, and system support services to insurers, primarily to town mutual insurers that are WRC reinsurance client companies. As of December 31, 2002, the unaudited GAAP-basis financial statement of WRC Systems, Inc., reported total assets of \$105,541, liabilities of \$67,185, and net equity of \$38,356. Operations for 2002 produced a net loss of \$37,047.

**WRC Agency, Inc.**

WRC Agency, Inc., provides insurance brokerage services through which agents of WRC client companies may place coverages for lines of insurance that the client companies are unable to offer as a direct insurer. As of December 31, 2002, the GAAP-basis unaudited financial statements of WRC Agency, Inc., reported total assets and total liabilities of \$22,980 and net owner's equity of \$0. Operations for 2002 resulted in net income of \$0.

**Wisconsin Adjusting Service, Inc. ("WASI")**

Wisconsin Adjusting Service, Inc., provides loss adjustment services related to liability claims for WRC and its client companies. Services provided to WRC are provided pursuant to an administrative services agreement. As of December 31, 2002, the unaudited GAAP basis financial statements of WASI reported total assets and total liabilities of \$90,586 and net owner's equity of \$0. Operations for 2002 resulted in net income of \$0, as all expenses of WASI are 100% reimbursed by WRC.

**Agreements with Affiliates****Administrative Service Agreements**

WRC maintains administrative services agreements with each of its subsidiaries. Each agreement was executed January 1, 1993, and is continuous with respect to automatic annual renewals. Pursuant to the agreements, WRC provides accounting, data processing, marketing, receptionist, secretarial, and all other administrative services necessary for the respective affiliates to conduct their normal business operations. WRC accounts for the time spent by its employees on behalf of the respective affiliates in providing administrative services. Pursuant to the agreements, WRC costs allocated to the affiliates and WRC direct expenses on behalf of the respective affiliates are reimbursed by the affiliates.

**Office Lease Agreements**

WRC maintains separate office lease agreements with each of its affiliates. The agreements provide for lease of office space in the WRC headquarters building, and the agreements are identical except for their respective specifications of leased WRC space and applicable annual rents. Premises leased to the affiliates range from 128 square feet leased to

WRC Systems, Inc., to 5,035 square feet leased to 1<sup>st</sup> Auto, and annual rents range from \$1,920 paid by WRC Systems, Inc., to \$75,525 paid by 1<sup>st</sup> Auto. The agreements provide that WRC pays for maintenance and upkeep of the leased spaces and for utility services excluding telephone.

#### **Consolidated Federal Income Tax Agreement**

WRC and each of its affiliates are party to a consolidated Federal income tax agreement. The agreement provides that WRC will file a consolidated Federal tax return for all parties to the agreement. The method used for allocation of Federal taxes among the agreement participants is as prescribed by Internal Revenue Service, and any regular tax liability of participants will be allocated based on the individual taxable income of each participant in proportion to the total consolidated taxable income. In the event that alternative minimum tax is applicable on the consolidated basis, the AMT liability will be allocated based on the effect on the total consolidated AMT by excluding the individual participant's contribution to the total consolidated tax. Final settlement of tax allocation will be paid by the respective participants within 90 days of filing of the consolidated Federal tax return.

## V. REINSURANCE

The company's reinsurance portfolio and strategy is described below. The company's contracts contain proper insolvency provisions.

### **Affiliated Ceding Contracts**

The following is a summary of the company's affiliated ceding reinsurance contracts with its parent, Wisconsin Reinsurance Corporation. WRC assumes a portion of the business written by 1<sup>st</sup> Auto primarily so as to participate in the potential profitability of the business written by 1<sup>st</sup> Auto.

1. Type: Underlying Automobile Aggregate Excess of Loss Reinsurance  
Reinsurer: Wisconsin Reinsurance Corporation  
Scope: The excess liability under policies issued by the company for all business classified as Automobile insurance  
Retention: Ultimate net loss equal to 80% of the company's net earned premium for the calendar year  
Coverage: Ultimate net loss for the calendar year in excess of 80% of the company's net earned premium for the calendar year, reinsurer's liability limited to the greater of \$600,000 or 5% of the company's net earned premium in the calendar year  
Warranty: The company warrants that maximum policy limits are \$500,000 Bodily Injury Liability each person each occurrence, and \$250,000 Property Damage Liability each occurrence.  
Premium: For the calendar year, the greater of \$240,000 or 1.70% of net earned premium for the subject business in the calendar year, annual deposit premium \$300,000  
Effective Date: January 1, 2003  
Termination: As of any December 31 by the company giving 90 days prior notice
2. Type: Automobile Liability Excess of Loss Reinsurance  
Reinsurer: Wisconsin Reinsurance Corporation  
Scope: The excess liability under policies issued by the company for business classified as Automobile Liability insurance  
Retention: 100% of \$150,000 ultimate net loss each loss occurrence  
Coverage: 100% of ultimate net loss in excess of \$150,000 each loss occurrence; reinsurer liability limited to \$50,000 each loss occurrence. In the event that all or any portion of the reinsurance provided under this agreement is exhausted

by loss, the amount so exhausted will be reinstated immediately from the time the loss occurrence commences under this treaty. Reinstatements will be unlimited in number and will apply to all loss occurrences commencing during the period this contract is in force.

Warranty: The company warrants that maximum policy limits are \$500,000 Bodily Injury Liability each person each occurrence, and \$250,000 Property Damage Liability each occurrence.

Premium: 6.8% of net earned premium on subject business for the calendar year, annual minimum premium \$1,023,200, annual deposit premium \$1,279,000

Effective date: January 1, 2003

Termination: As of any December 31 by the company giving 90 days prior notice

3. Type: Auto Physical Damage Catastrophe Excess Reinsurance

Reinsurer: Wisconsin Reinsurance Corporation

Scope: The excess liability under policies issued by the company for business classified as Automobile Physical Damage insurance

Retention: \$150,000 of ultimate net loss liability each loss occurrence

Coverage: 100% of ultimate net loss in excess of \$150,000 each loss occurrence; reinsurer liability limited to 100% of \$400,000 each loss occurrence. In the event that all or any portion of the reinsurance provided under this agreement is exhausted by loss, the amount so exhausted will be reinstated immediately from the time the loss occurrence commences under this treaty.

Premium: 2.5% of net earned premium on subject business for the calendar year, minimum annual and deposit premium \$250,000

Effective date: January 1, 2003

Termination: As of any December 31 by either party giving 90 days prior notice

4. Type: Workers Compensation and Employers Liability Excess of Loss Reinsurance

Reinsurer: Wisconsin Reinsurance Corporation

Scope: The excess liability under policies issued by the company for business classified as Workers' Compensation insurance (written on a voluntary basis) and Employer's Liability insurance with regard to bodily injury by accident incurred during the calendar year or bodily injury by disease caused or aggravated by the conditions of employment incurred during the contract year

Retention: \$10,000 of ultimate net loss each loss occurrence

Coverage: 100% of ultimate net loss in excess of \$10,000 each loss occurrence; reinsurer liability limited to 100% of \$40,000 each loss occurrence. In the event that all or any portion of the reinsurance provided under this agreement is exhausted by loss, the amount so exhausted will be reinstated immediately

from the time the loss occurrence commences under this treaty. There will be not additional premium charged for any such reinstatement of coverage. Reinstatements will be unlimited in number and apply to all loss occurrences commencing during the period the contract is in force.

Warranty: The company warrants that maximum policy limits are \$1,000,000 for Employer's Liability business.

Premium: For the calendar year, the greater of \$50,000 or 26.25% of the net earned Workers' Compensation premium for the calendar year, annual deposit premium \$50,000

Effective date: January 1, 2003

Termination: As of any December 31 by either party giving 90 days prior notice

### **Nonaffiliated Ceding Contracts**

The following is a summary of the company's nonaffiliated ceding reinsurance contracts. The company cedes portions of its written business to third party reinsurers for risk management purposes and to mitigate risk in the event of catastrophic loss.

1. Type: Automobile Aggregate Excess of Loss Reinsurance

Reinsured: 1<sup>st</sup> Auto Property and Casualty Insurance Company and Wisconsin Reinsurance Corporation

Reinsurers: Platinum Underwriters Reinsurance, Inc. 45%  
SCOR Reinsurance Company 45%

Additional Reinsurance: For 1<sup>st</sup> Auto losses subject to this treaty, Wisconsin Reinsurance Corporation has a 10% participation through the Underlying Automobile Aggregate Excess of Loss Agreement of 1<sup>st</sup> Auto and WRC

Scope: All business classified by the company as Automobile

Retention: 85% of the company's Gross Net Earned Premium Income ("GNEPI")

Coverage: Reinsurance annual aggregate limit equal to 95% of the greater of 20% of the company's GNEPI or \$2,857,600 in the aggregate for each annual period the agreement is in effect

Premium: 2.96% of subject premium written, minimum annual premium \$444,800, annual deposit premium \$556,000

Effective date: January 1, 2003

Termination: As of any December 31 by either party giving 90 days advance notice

Status: Business ceded by the WRC companies under this treaty is currently limited to risks ceded by 1st Auto, and WRC does not cede business under the treaty. The treaty provides to WRC a reinsurance facility for the possible

cession of automobile risks that the company could potentially assume in the future from one or more unaffiliated direct writers of automobile risks.

2. Type: Automobile Quota Share Reinsurance
 

Reinsurers:	Arch Reinsurance Company	66%
	Continental Casualty Company	34%

Reinsured: 1<sup>st</sup> Auto Property & Casualty Insurance Company

Scope: All business written and classified by the company as Private Passenger and Commercial Automobile Physical Damage

Retention: 40% quota share net retained liability on subject risks. In addition, on an annual basis, the company retains losses incurred in the loss corridor between 76-86% of net written premium for the contract year, and the company retains losses incurred for the contract year which exceed 96% of net written premium for the contract year.

Warranty: Maximum loss recoverable on any one loss occurrence \$150,000. Maximum insured individual commercial vehicle value \$65,000

Coverage: 60% quota share participation in the company's net retained liability on subject risks. Reinsurance from the company's automobile physical damage catastrophe excess of loss treaty will inure to the benefit of this contract.

Premium: 60% of subject premium written

Commission: 24% of ceded net written premium at a 69% loss ratio, sliding 1:1 to a maximum of 34% at a 59% loss ratio

Effective date: April 1, 2003

Termination: As of any March 31 with 90 days prior notice
  
3. Type: First Multiple Line Excess of Loss Reinsurance
 

Reinsurers:	Scor Reinsurance Company	50%
	Platinum Underwriters Reinsurance, Inc.	50%

Reinsured: 1<sup>st</sup> Auto Property and Casualty Insurance Company and Wisconsin Reinsurance Corporation

Scope: With respect to WRC, business classified as Property Reinsurance assumed by WRC for Class B – Pro Rata and Class C – Excess Per Risk, and business classified as Casualty Reinsurance assumed by WRC for Class A – Casualty

The portion of this agreement applicable to 1<sup>st</sup> Auto includes business classified as direct and assumed Workers Compensation/Employers Liability business, net retained Umbrella Liability business, and Automobile Liability business written directly by 1<sup>st</sup> Auto.

Retention: A. Property  
100% of \$200,000 ultimate net loss each risk, each loss



- B. Casualty Other than Workers Compensation  
100% of \$200,000 ultimate net loss each loss occurrence
  - C. Workers Compensation  
100% of \$50,000 ultimate net loss each loss occurrence
  - D. Combined Property, Casualty, Net Umbrella, and Workers Compensation  
100% of \$200,000 loss liability for combined coverages each loss occurrence. For losses involving coverages of A, B, and/or C, recoveries made under the coverages A, B, and C will inure to the benefit of the reinsurance provided under D.
- Coverage:
- A. Property  
100% of \$100,000 excess of \$200,000 ultimate net loss each risk, each loss. Reinsurance limit \$300,000 any one loss occurrence
  - B. Casualty Other than Workers Compensation  
100% of \$100,000 excess of \$200,000 ultimate net loss each loss occurrence
  - C. Workers Compensation  
100% of \$250,000 excess of \$50,000 ultimate net loss each loss occurrence
  - D. Combined Property, Casualty, Net Umbrella, and Workers Compensation  
100% of \$200,000 loss liability excess of \$200,000 combined coverages each loss occurrence. For losses involving coverages of A, B, and/or C, recoveries made under the coverages A, B, and C will inure to the benefit of the reinsurance provided under D.
- Warranty: The company warrants that it will maintain a 92.5% Quota Share Reinsurance and \$3,000,000 excess of \$2,000,000 Excess of Loss Reinsurance contract for Umbrella Liability, and that such reinsurance shall inure to the benefit of the First Multiple Line Excess of Loss reinsurer.
- Premium: 3.91% GNEPI, adjusted annually. Minimum annual premium \$1,155,984, annual deposit premium \$1,444,980. Year-end adjustment as soon as possible at the end of the agreement year
- Effective date: January 1, 2003
- Termination: As of any December 31 by either party giving 90 days prior notice
4. Type: Second Multiple Line Excess of Loss Reinsurance
- Reinsurers: Platinum Underwriters Reinsurance, Inc. 50%  
SCOR Reinsurance Company 50%
- Reinsured: 1<sup>st</sup> Auto Property and Casualty Insurance Company and Wisconsin Reinsurance Corporation

Scope: Business classified as Property Reinsurance assumed by WRC for Class B – Pro Rata and Class C – Excess Per Risk, and business classified as Casualty Reinsurance assumed by WRC for Class A – Casualty  
The contract also includes business classified as direct and assumed Workers Compensation/Employers Liability business, net retained Umbrella Liability business, and Automobile Liability business written directly by 1<sup>st</sup> Auto.

Retention: Property  
100% of \$300,000 ultimate net loss each risk each loss  
  
Casualty (including workers compensation)  
100% of \$300,000 ultimate net loss each loss occurrence

Coverage: Property  
100% of \$700,000 excess of \$300,000 ultimate net loss each risk each loss.  
Reinsurance limit \$1,400,000 any one loss occurrence  
  
Casualty (including workers compensation)  
100% of \$700,000 excess of \$300,000 of ultimate net loss each loss occurrence

Premium: 3.01% GNEPI, adjusted annually. Minimum annual premium \$889,900, annual deposit premium \$1,112,376. Year-end adjustment as soon as possible at the end of the agreement year

Effective date: January 1, 2003

Termination: As of any December 31 by either party giving 90 days prior notice

5. Type: Third Multiple Line Excess of Loss Reinsurance

Reinsurers: Scor Reinsurance Company 50%  
Platinum Underwriters Reinsurance, Inc 50%

Reinsured: 1<sup>st</sup> Auto Property and Casualty Insurance Company and Wisconsin Reinsurance Corporation

Scope: Business classified as Property Reinsurance assumed by WRC for Class B – Pro Rata and Class C – Excess Per Risk, and business classified as Casualty Reinsurance assumed by WRC for Class A – Casualty  
  
The contract also includes business classified as direct and assumed Workers Compensation/Employers Liability business, net retained Umbrella Liability business, and Automobile Liability business written directly by 1<sup>st</sup> Auto and Casualty

Retention: Property  
\$1,000,000 of ultimate net loss each risk, each loss  
  
Casualty/Clash  
\$1,000,000 of ultimate net loss each loss occurrence  
  
Workers Compensation  
\$1,000,000 of ultimate net loss each loss occurrence

Coverage      Property  
                   \$3,000,000 excess of \$1,000,000 ultimate net loss each risk, each loss.  
                   Reinsurance limit \$6,000,000 any one loss occurrence and in annual  
                   aggregate

                  Casualty/Clash  
                   100% of \$1,500,000 excess of \$1,000,000 ultimate net loss each loss  
                   occurrence. Reinsurance annual aggregate limit \$3,000,000

                  Workers Compensation  
                   100% of \$4,000,000 excess of \$1,000,000 ultimate net loss each loss  
                   occurrence. Reinsurance annual aggregate limit \$8,000,000

Premium:      1.09% GNEPI, adjusted annually. Minimum annual premium \$323,200,  
                   annual deposit premium \$404,000. Year-end adjustment as soon as  
                   possible at the end of the agreement year

Effective date: January 1, 2003

Termination:    As of any December 31 by either party giving 90 days prior notice

6. Type:              Workers Compensation and Employers Liability Excess of Loss
- Reinsurers:      Platinum Underwriters Reinsurance, Inc.                              50%  
                          SCOR Reinsurance Company    50%
- Reinsured:        1<sup>st</sup> Auto Property and Casualty Insurance Company and Wisconsin  
                          Reinsurance Corporation
- Scope:             Business classified by the company as Workers Compensation and  
                          Employers Liability
- Retention:        100% of \$5,000,000 ultimate net loss each occurrence
- Coverage          100% of \$5,000,000 excess of \$5,000,000 ultimate net loss each  
                          occurrence. In the event of loss under this coverage as well as a loss on  
                          another policy subject to the company's Multiple Line Excess of Loss or the  
                          Umbrella Liability Quota Share and Excess of Loss treaties, where the  
                          reinsurer's liability exceeds \$10,000,000, the reinsurer's liability under this  
                          contract will be decreased proportionally so that not more than \$10,000,000  
                          of liability is ceded to the reinsurer from any one loss occurrence.
- Warranty:         The company's maximum policy limits for Employers Liability is \$1,000,000.  
                          Audit premiums booked and received after the close of any calendar year will  
                          be treated as earned premiums in the calendar year in which they are  
                          received.
- Premium:         Annual premium \$100,000
- Reinstatement:   One at 100% additional premium
- Effective date:    January 1, 2003
- Termination:      As of any December 31 by either party giving 90 days' prior notice

7. Type:	Umbrella Liability Quota Share and Excess of Loss Reinsurance	
Reinsurers:	SCOR Reinsurance Company	50%
	Platinum Underwriters Reinsurance, Inc.	50%
Reinsured:	1 <sup>st</sup> Auto Property and Casualty Insurance Company and Wisconsin Reinsurance Corporation	
Scope:	Business classified by the company as Personal and Commercial Umbrella Liability as written on a direct basis by 1 <sup>st</sup> Auto and Casualty Insurance Company or assumed under reinsurance contracts written by and on behalf of Wisconsin Reinsurance Corporation	
Retention:	<p>Quota Share</p> <p>7.5% quota share of loss liability any one Umbrella policy, applicable for maximum Umbrella coverage risk of \$2,000,000. Company retains 7.5% quota share of loss liability on \$4,000,000 of insured Umbrella coverage risk any one loss occurrence.</p> <p>Excess of loss</p> <p>\$2,000,000 ultimate net loss each loss occurrence</p>	
Coverage:	<p>Quota Share</p> <p>92.5% quota share of loss liability any one Umbrella policy, applicable for maximum Umbrella coverage risk of \$2,000,000, maximum reinsurer liability \$1,850,000 any one policy. Reinsurer covers 92.5% quota share of loss liability on \$4,000,000 of insured Umbrella coverage risk any one loss occurrence, maximum reinsurer liability \$3,700,000 any one occurrence.</p> <p>Excess of Loss</p> <p>100% of the company's ultimate loss liability in excess of \$2,000,000 each loss occurrence; reinsurer liability limited to 100% of \$3,000,000 excess loss each loss occurrence</p>	
Premium:	<p>Quota Share</p> <p>92.5% of the Gross Original Premium for Umbrella business applicable to the first \$2,000,000 of liability covered</p> <p>Excess of Loss</p> <p>100% of the Gross Original Premium for Umbrella business applicable to limits of liability over \$2,000,000, always subject to Reinsurer's limit of liability of \$3,000,000</p>	
Commissions:	27.5% commission on the net premium ceded or paid	
Effective date:	January 1, 2003	
Termination:	As of any December 31 by either party giving 90 days' prior notice	
Warranties:	The company warrants that it will require the following minimum underlying policy limits:	
	Personal Auto	\$300,000/\$300,000/\$100,000 or \$250,000/\$500,000/\$100,000
	CPL or FCPL	\$300,000 CSL or \$500,000 CSL

Recreational Vehicles	\$300,000/\$300,000/\$100,000 or \$250,000/\$500,000/\$100,000 or \$300,000 CSL or \$500,000 CSL
Commercial Auto	\$500,000 CSL
Commercial Liability	\$500,000 CSL

## **VI. FINANCIAL DATA**

The following financial statements reflect the financial condition of the company as reported to the Commissioner of Insurance in the December 31, 2002, annual statement. Also included in this section are schedules that reflect the growth of the company, NAIC Insurance Regulatory Information System ratio results for the period under examination, and the compulsory and security surplus calculation. Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Surplus per Examination."

**1<sup>st</sup> Auto & Casualty Insurance Company**  
**Assets**  
**As of December 31, 2002**

	<b>Assets</b>	<b>Nonadmitted Assets</b>	<b>Net Admitted Assets</b>
Bonds	\$15,500,558		\$15,500,558
Stocks:			
Common stocks	4,296,083		4,296,083
Cash	157,341		157,341
Agents' balances or uncollected premiums:			
Premiums and agents' balances in course of collection	1,840,466	\$27,932	1,812,534
Reinsurance recoverable on loss and loss adjustment expense payments	57,156		57,156
Federal and foreign income tax recoverable and interest thereon	1,083,878	229,214	854,664
Electronic data processing equipment and software	94,884	77,032	17,852
Interest, dividends, and real estate income due and accrued	219,741		219,741
Other assets nonadmitted:			
Furniture, equipment, and supplies	1,580	1,580	
Write-ins for other than invested assets:			
Third party claims deposits	<u>15,000</u>	<u>          </u>	<u>15,000</u>
Total Assets	<u>\$23,266,687</u>	<u>\$335,758</u>	<u>\$22,930,929</u>

**1<sup>st</sup> Auto & Casualty Insurance Company**  
**Liabilities, Surplus, and Other Funds**  
**As of December 31, 2002**

Losses	\$9,238,897	
Loss adjustment expenses	1,301,522	
Commissions payable, contingent commissions, and other similar charges	511,156	
Other expenses (excluding taxes, licenses, and fees)	108,978	
Taxes, licenses, and fees (excluding federal and foreign income taxes)	38,192	
Unearned premiums	5,697,676	
Advance premium	169,776	
Ceded reinsurance premiums payable (net of ceding commissions)	528,134	
Remittances and items not allocated	103,550	
Payable to parent, subsidiaries, and affiliates	<u>233,990</u>	
 Total Liabilities		 \$17,931,871
 Common capital stock	 2,000,000	
Gross paid in and contributed surplus	3,000,000	
Unassigned funds (surplus)	<u>(942)</u>	
 Surplus as Regards Policyholders		 <u>4,999,058</u>
 Total Liabilities and Surplus		 <u>\$22,930,929</u>



**1<sup>st</sup> Auto & Casualty Insurance Company**  
**Summary of Operations**  
**For the Year 2002**

**Underwriting Income**

Premiums earned		\$17,882,863
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Deductions:

Losses incurred	\$14,486,252	
Loss expenses incurred	1,580,706	
Other underwriting expenses incurred	<u>4,245,134</u>	

Total underwriting deductions		<u>20,312,092</u>
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Net underwriting loss		(2,429,229)
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**Investment Income**

Net investment income earned	760,544	
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Net realized capital	<u>37,898</u>	
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Net investment gains		798,442
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**Other Income**

Finance and service charges not included in premiums	<u>192,483</u>	
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Total other income		<u>192,483</u>
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Net loss before federal and foreign income taxes		(1,438,304)
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Federal and foreign income taxes incurred		<u>(271,369)</u>
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Net loss		<u><u>\$(1,166,935)</u></u>
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**1<sup>st</sup> Auto & Casualty Insurance Company**  
**Cash Flow**  
**For the Year 2002**

Premiums collected net of reinsurance	\$19,329,256		
Deduct:			
Loss and loss adjustment expenses paid (net of salvage or subrogation)	11,866,176		
Underwriting expenses paid	<u>4,006,709</u>		
Cash from underwriting		\$3,456,371	
Net investment income		777,952	
Other income (expenses):			
Write-ins for miscellaneous items:			
Financial and service charges	<u>192,483</u>		
Total other income		192,483	
Deduct:			
Federal income taxes paid		<u>136,075</u>	
Net cash from operations			\$4,290,731
Proceeds from investments sold, matured, or repaid:			
Bonds	4,697,814		
Stocks	<u>3,650,056</u>		
Total investment proceeds		8,347,870	
Cost of investments acquired (long-term only):			
Bonds	8,429,191		
Stocks	<u>3,786,015</u>		
Total investments acquired		<u>12,215,206</u>	
Net cash from investments			(3,867,336)
Cash provided from financing and miscellaneous sources:			
Net transfers from affiliates	101,762		
Other cash provided	<u>156,541</u>		
Total		258,303	
Cash applied for financing and miscellaneous uses:			
Other applications	<u>93,183</u>		
Total		<u>93,183</u>	
Net cash from financing and miscellaneous sources			<u>165,120</u>
<b>Reconciliation</b>			
Net change in cash and short-term investments			588,515

Cash and short-term investments, December 31, 2001	<u>(431,174)</u>
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Cash and short-term investments, December 31, 2002	<u>\$157,341</u>
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**1<sup>st</sup> Auto & Casualty Insurance Company**  
**Compulsory and Security Surplus Calculation**  
**December 31, 2002**

Assets		\$22,930,929
Less security surplus of insurance subsidiaries		
Less liabilities		<u>17,931,871</u>
Adjusted surplus		4,999,058
Annual premium:		
Lines other than accident and health	\$19,586,876	
Factor	<u>20%</u>	
Compulsory surplus (subject to a minimum of \$2 million)		<u>3,917,375</u>
Compulsory surplus excess		<u>\$ 1,081,683</u>
Adjusted surplus (from above)		\$4,999,058
Security surplus: (140% of compulsory surplus, factor reduced 1% for each \$33 million in premium written in excess of \$10 million, with a minimum factor of 110%)		<u>5,484,325</u>
Security surplus deficit		<u>\$ (485,267)</u>

**1<sup>st</sup> Auto & Casualty Insurance Company**  
**Reconciliation and Analysis of Surplus**  
**For the Five Period Ending December 31, 2002**

The following schedule is a reconciliation of total surplus during the period under examination as reported by the company in its filed annual statements:

	<b>2002</b>	<b>2001</b>	<b>2000</b>	<b>1999</b>
Surplus, beginning of year	\$6,686,656	\$6,816,283	\$7,222,653	\$6,648,935
Net income	(1,166,935)	161,235	(257,928)	486,978
Net unrealized capital gains or (losses)	(750,978)	(553,419)	(180,735)	104,320
Change in net deferred income tax	509,874	274,882		
Change in non-admitted assets	(279,559)	(50,378)	32,293	(17,580)
Cumulative effect of changes in accounting principles		38,053		
Surplus, end of year	<u>\$4,999,058</u>	<u>\$6,686,656</u>	<u>\$8,816,283</u>	<u>\$7,222,653</u>

**1<sup>st</sup> Auto & Casualty Insurance Company**  
**Insurance Regulatory Information System**  
**For the Five-Year Period Ending December 31, 2002**

The company's NAIC Insurance Regulatory Information System ("IRIS") results for the years under examination are summarized in the following table. Unusual IRIS results during the period are denoted with asterisks, and are discussed following the table of IRIS ratio data.

<b>Ratio</b>	<b>2002</b>	<b>2001</b>	<b>2000</b>	<b>1999</b>
#1 Gross Premium to Surplus	450%	226%	188%	181%
#2 Net Premium to Surplus	392%*	196%	179%	83%
#3 Change in Net Writings	50%	7%	103%*	-10%
#4 Surplus Aid to Surplus	0%	0%	0%	6%
#5 Two-Year Overall Operating Ratio	102%*	99%	98%	101%*
#6 Investment Yield	4.2%*	4.9%	5%	4.6%
#7 Change in Surplus	-19%*	1%	0%	6%
#8 Liabilities to Liquid Assets	89%	72%	63%	49%
#9 Agents' Balances to Surplus	36%	19%	12%	12%
#10 One-Year Reserve Devel. to Surplus	-3%	-11%	-8%	0%
#11 Two-Year Reserve Devel. to Surplus	-12%	-9%	-6%	-3%
#12 Estimated Current Reserve Def. To Surplus	-28%	-20%	-25%	5%

IRIS ratio number 2, Net Premium to Surplus, evaluates the degree of risk that an insurer bears due to its written premium volume relative to the amount of surplus available to absorb unanticipated loss variations. The company's unusual result in 2002 was due to 33%

growth of direct premiums written that arose as several competitor insurers discontinued writing personal auto coverages within the company's territory, which resulted in correspondingly increased market demand for the company's products. Surplus decreased 25% in 2002 due to unfavorable incurred loss experience on the company's auto liability business and due to unrealized losses on the company's portfolio of common stock investments.

IRIS ratio number 3, Net Change in Writings, evaluates the year-to-year change in an insurer's net written premium. The company's unusual result in 2000 was due in large part to termination of the company's then-existing quota share reinsurance program. The company's unusual result in 2002 was due to significant premium growth.

IRIS ratio number 5, Two-Year Overall Operating Ratio, evaluates an insurer's profitability, and equals an insurer's loss ratio plus its expense ratio minus its investment income ratio. The company's unusual results in 1999 and 2002 were due to adverse loss experience in 1999 and 2002.

IRIS ratio number 6, Investment Yield, evaluates the yield on investments that an insurer recognizes during an operating year as investment income and realized gains compared to annual average cash and total invested assets. The company's unusual result in 2002 was due to unrealized losses in the company's portfolio of common stock invested assets.

IRIS ratio number 7, Change in Surplus, evaluates an insurer's year-to-year change in policyholder surplus. The company's unusual result in 2002 was due to unfavorable incurred loss experience on the company's auto liability business and due to unrealized losses on the company's portfolio of common stock invested assets.

### Growth of 1<sup>st</sup> Auto & Casualty Insurance Company

Year	Admitted Assets	Liabilities	Surplus As Regards Policyholders	Net Income
2002	22,930,929	17,931,871	4,999,058	(1,166,935)
2001	18,610,966	11,924,310	6,686,656	161,235
2000	16,206,947	9,390,664	6,816,283	(257,928)
1999	12,588,674	5,366,021	7,222,653	486,978
1998	10,857,311	4,208,376	6,648,935	(732,693)

Year	Gross Premium Written	Net Premium Written	Premium Earned	Loss And LAE Ratio	Expense Ratio	Combined Ratio
2002	22,474,030	19,586,876	17,882,863	89.8%	20.7%	110.5%
2001	15,133,302	13,088,545	12,124,879	81.2%	21.7%	102.9%
2000	12,703,055	12,203,610	10,714,047	86.1%	21.7%	107.8%
1999	13,066,741	6,010,772	6,002,537	79.2%	18.1%	97.3%
1998	12,523,301	6,672,943	5,520,469	93.4%	28.1%	121.5%

During the period under examination, 1<sup>st</sup> Auto's admitted assets increased by 111%, net premium written increased by 194%, and surplus decreased 25%. The company's underwriting results have been volatile due to losses arising from severe weather events and adverse experience in auto liability business. The company's 62% increase of net premium written in 2002 was primarily due to increased market demand that resulted from the withdrawal of significant competitor insurers from the personal auto market. Underwriting losses in 2002 of \$2,429,229 were primarily due to the increased premium volume and corresponding increased unearned premium reserves, underwriting expense, and commission expense. The company established a moratorium on accepting new business effective December 1, 2002 through July 1, 2003. In July 2003, the company resumed accepting new business from a limited segment of agents, and in November 2003, the company resumed accepting business from agents whose book of business for 2000 through 2002 had a loss ratio below 60%.

**Reconciliation of Surplus per Examination**

The examination did not result in any balance sheet account reclassifications or any adjustments to surplus. As of December 31, 2002, the company reported total surplus of \$4,999,058.



## VII. SUMMARY OF EXAMINATION RESULTS

### Compliance with Prior Examination Report Recommendations

There were nine specific comments and recommendations in the previous examination report. Comments and recommendations contained in the previous examination report and actions taken by the company are as follows:

1. Affiliated Balances – It is recommended that the company obtain signed written agreements with all affiliates.

Action—Compliance

2. Other Expenses – It is recommended that the company properly report, in accordance with the NAIC Annual Statement Instructions – Property/Casualty, premium taxes payable as Taxes, Licenses, and Fees on all future annual statements.

Action—Compliance

3. Aggregate Write-Ins for Other Than Invested Assets – It is recommended that the company properly report, in accordance with the NAIC Annual Statement Instructions – Property/Casualty, state income tax balances as Taxes, Licenses, and Fees on all future annual statements.

Action—Compliance

4. Agents Balances – It is recommended that the company properly report, in accordance with the NAIC Annual Statement Instructions – Property/Casualty, premiums in suspense as Remittances and Items Not Allocated on all future annual statements.

Action—Compliance

5. Information Technology Environment – It is recommended that the company secure the computer room against unauthorized physical access.

Action—Compliance

6. Information Technology Environment – It is recommended that the company require employees to change their passwords, at least on a quarterly basis.

Action—Compliance

7. Information Technology Environment – It is recommended that the company more frequently review the number of failed system access attempts by employees in order to identify any problematic trends.

Action—Compliance

8. Information Technology Environment – It is recommended that the company establish formal procedures for adding, changing, and deleting access by employees to its networks and applications and also perform periodic reviews of the current access allowed to determine if access allowed is commensurate with the employee's job description.

Action—Partial Compliance. Further comment and recommendation is included in the examination findings section of this report captioned "Information Technology."

9. Disaster Recovery Plan – It is recommended that the company integrate the comments listed above when updating its Disaster Recovery Plan.

Action—Partial Compliance. Further comment and recommendation is included in the examination findings section of this report captioned "Disaster Recovery Plan."

## **Summary of Current Examination Results**

### **Affiliated Reinsurance Contracts—Regulatory Filings**

1<sup>st</sup> Auto is party to various affiliated reinsurance treaties, described in Section V. of this report captioned “Reinsurance,” whereby the company cedes portions of its direct insurance risk to Wisconsin Reinsurance Corporation. The business is ceded to WRC primarily to enable WRC to participate in potential underwriting profitability of 1<sup>st</sup> Auto’s direct written business.

Pursuant to s. Ins 40.04 (2) (c), Wis. Adm. Code, enactment or modification of an insurer’s reinsurance contracts with affiliates is subject to the prior approval of the Commissioner if the contract’s subject reinsurance premium or change in insurer liability equals or exceeds 5% of the insurer’s prior-year policyholder surplus. A reinsurance agreement that requires the Commissioner’s approval must be reported to the Commissioner at least 30 days prior to the effective date of the agreement.

Examination review determined that, from time-to-time during the years under examination, one or more of the company’s affiliated reinsurance contracts was either established or modified and pertained to reinsurance premium or insurer liability in excess of 5% of the company’s prior-year surplus. The company did not submit the applicable reinsurance agreements to the Commissioner for review. It is recommended that the company obtain the prior approval of the Commissioner for each newly established or modified reinsurance agreement that entails reinsurance premium or insurer liability equal to or in excess of 5% of the company’s prior-year surplus, in compliance with s. Ins 40.04 (2) (c), Wis. Adm. Code.

### **Deferred Installment Premiums**

Examination review observed that the company allows a policyholder the option of paying insurance policy premium in installments. The company bills the total premium at the beginning of the coverage period but a policyholder may elect to remit an installment payment, whereupon subsequent installment billings are issued by the company. Installment payments are due when billed, and an insurance policy is canceled in the event of nonpayment of installment premiums.

The company classified all of its reported premium receivable assets as premiums in course of collection, and did not classify any premium receivables as deferred premium assets. However, a portion of the company's premium receivables is comprised of installment receivables that are due in a subsequent time period, which should be classified in the statutory financial statement on page 2, line 10.2, under the caption "Premiums, agent's balances and installments booked but deferred and not yet due." The company does not have readily available data to establish a valuation of its installment premium as of year-end 2002, and calculation of installment premium data is not available from the data system currently used for commercial insurance risks. It is recommended that the company properly classify and report premiums in course of collection and deferred installment premiums in its statutory financial statements, in accordance with NAIC Annual Statement Instructions—Property and Casualty.

#### **Affiliated Balances**

The examination found that the company's reported affiliated balance asset was calculated as the net of the company's receivable from one affiliate with the company's unrelated liability to a second affiliate. Statutory accounting guidance provides that amounts due to or from affiliates may not be offset and reported net unless the reporting entity has a valid right of setoff to discharge a portion of debt owed to one party by applying an amount the other party owes to the reporting entity. An insurer may not setoff amounts owed from one affiliate against amounts owed to a different affiliate. It is recommended that the company not offset amounts receivable from one affiliate against liability owed to a second affiliate, in conformity with NAIC Accounting Practices and Procedures Manual SSAP # 64.

#### **Information Technology**

Internal controls necessary to maintain the integrity of a business entity's information technology environment include establishment of formal procedures for the administration of employee access to company information systems. The formal procedures must establish required standards and practices regarding monitoring of individual user's authorization within the information technology environment, and must administer and document the adding, changing, and deletion of access of employees to company networks and applications. Proper

administration of user access also requires that a business entity perform periodic reviews of the current access authorization status of user accounts, to determine if authorized access is commensurate with an employee's employment status, job description, and work assignments.

Examination review determined that the company has not developed a formal process to document IT access changes or the results of periodic reviews of IT access authorizations. The previous examination also noted the absence of adequate internal controls regarding employee access to the company's information technology systems, and recommended that the company address the noted deficiency. The company is in partial compliance with the previous recommendation. It is again recommended that the company establish formal procedures to administer adding, changing, and deleting the access authority of employees to the company's computer networks and applications, and that the company perform periodic reviews of the access authority status of user accounts to determine if access allowed to individual users is commensurate with users' respective work assignments and responsibilities.

#### **Disaster Recovery Plan**

The company has established contingency planning for the restoration of company data records and the resumption of company business operations in the event of business interruption. The examiners determined that there were deficiencies in the company's testing of its disaster recovery plan. The company did not document its testing of the IT portion of the disaster recovery plan, and did not perform testing of the non-IT portion of the plan. The previous examination also noted the deficiencies cited by the current examination, and recommended that the company address the noted deficiencies. The company is in partial compliance with the previous recommendation. It is again recommended that the company perform and formally document annual review, updating, and testing of its disaster recovery plan.

#### **Business Planning**

The company has not conducted comprehensive business planning to evaluate intermediate or long-term business strategies, and has not established a formal tactical or strategic business plan. Strategic business planning is a fundamental need for an insurer the size of the company, to inform the company's decision making and to actively direct the affairs of the

company toward explicit business objectives. The company's business planning should entail the comprehensive evaluation of current and prospective business opportunities and risks, and should incorporate pro-forma quantitative analysis and modeling of company product mix, pricing, capital expenditure needs, and potential future financial performance under alternative planning initiatives and under a reasonable range of possible future business environments.

The company's parent plans to establish working business planning groups and to initiate comprehensive business planning in 2004. WRC's and 1<sup>st</sup> Auto's capability to engage in business planning has been constrained in the past due to limited employee staff and quantitative analysis resources, but WRC has recently taken steps to add needed senior staff members and to provide analytical resources needed to perform planning activities. It is recommended that the company engage in substantive business planning activities and that the company develop and adequately document a comprehensive strategic business plan.

### **Capital Stock Disclosures**

Examiners reviewed the presentation of the company's Policyholder Surplus section of its balance sheet. The total amount reported for Policyholder Surplus is correct. Since the date of the company's demutualization, the company reported "Capital stock" of \$2,000,000. According to SSAP #72, "Surplus and Quasi-Reorganizations", the "Capital stock" should be valued at the number of shares multiplied by the par value or stated value, with the amount of capital received in excess of par value or stated value reported as "Gross paid-in and contributed surplus". The same situation applied to the reporting of "Preferred stock." The company replied to general interrogatory #17 consistent with its balance sheet presentation.

The reported and corrected data for the company's surplus accounts and for capital funds received from issuance of common and preferred stock as of December 31, 2002, is reflected in the following table:

	<b>Reported</b>	<b>Corrected</b>
	<b>Capital Funds</b>	<b>Capital Funds</b>
Common Capital Stock	\$2,000,000	\$500
Gross Paid-in and Contributed Surplus	3,000,000	4,999,500
Unassigned Funds	(942)	(942)
Total Surplus	\$4,999,058	\$4,999,058

NAIC Accounting Practices and Procedures Manual # 72 provides that “Capital stock” represents the number of shares issued times the par value per share, and the financial statement caption “Gross paid-in and contributed surplus” represents the amount of capital received in excess of the par value of issued capital stock. The reported and corrected data for the company’s surplus accounts and for capital funds received from issuance of common and preferred stock as of December 31, 2002 is reflected in the following table:

	<b>Reported</b>	<b>Corrected</b>
	<b>Capital Funds</b>	<b>Capital Funds</b>
Common Capital Stock	\$2,000,000	\$500
Gross Paid-in and Contributed Surplus	3,000,000	4,999,500
Unassigned Funds	(942)	(942)
Total Surplus	\$4,999,058	\$4,999,058

It is recommended that the company correctly report capital stock par values, and properly report capital and surplus balances using appropriate statutory annual statement convention captions, in compliance with NAIC Accounting Practices and procedures Manual SSAP #72.

## **VIII. CONCLUSION**

1<sup>st</sup> Auto & Casualty Insurance Company is a Wisconsin domiciled property and casualty insurer. The company was incorporated September 21, 1991, as an operating insurance subsidiary of Wisconsin Reinsurance Corporation. The company was established with \$3 million of capital in 1991, and received \$2 million of additional capital contributed by WRC in 1997.

1<sup>st</sup> Auto markets insurance policies in a four-state territory, and its primary business lines are personal, farm, and commercial automobile insurance. The company markets its products to customers who are policyholders of small mutual insurance companies that are reinsured clients of WRC, and employs independent and captive insurance agents of the WRC client companies to serve as insurance agents of 1<sup>st</sup> Auto.

During the period under examination, admitted assets increased 111%, net premium written increased 194%, and surplus decreased 25%. The company had underwriting losses in 2000 and 2001 primarily due to severe weather events and adverse loss experience in auto liability business. In 2002, the company had a 48.5% increase in gross premium written largely due to the withdrawal of competitors from the personal automobile insurance market. The corresponding 2002 increase in unearned premium reserves, expenses, and commissions gave rise to an underwriting loss of \$2.4 million and resulted in much of the surplus decrease experienced during the four-year period.

The current examination did not result in reclassification of account balances or adjustment of surplus as reported by the company. The examination determined that the company was in compliance with seven of the nine recommendations made by the previous examination. The current examination resulted in seven recommendations, two of which were repeated from the previous examination. As of December 31, 2002, the company had reported total admitted assets of \$22,930,929, total liabilities of 17,931,871, and policyholders surplus of \$4,999,058.



## IX. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 33 - Affiliated Reinsurance Contracts-Regulatory Filings—It is recommended that the company obtain the prior approval of the Commissioner for each newly established or modified reinsurance agreement that entails reinsurance premium or insurer liability equal to or in excess of 5% of the company's prior-year surplus, in compliance with s Ins 40.04 (2) (c), Wis. Adm. Code
2. Page 34 - Deferred Installment Premiums—It is recommended that the company properly classify and report premiums in course of collection and deferred installment premiums in its statutory financial statements, in accordance with NAIC Annual Statement Instructions—Property and Casualty.
3. Page 34 - Affiliated Balances—It is recommended that the company not offset amounts receivable from one affiliate against liability owed to a second affiliate, in compliance with NAIC Accounting Practices and Procedures Manual SSAP # 64.
4. Page 35 - Information Technology—It is again recommended that the company establish formal procedures to administer adding, changing, and deleting the access authority of employees to the company's computer networks and applications, and that the company perform periodic reviews of the access authority status of user accounts to determine if access allowed to individual users is commensurate with users' respective work assignments and responsibilities.
5. Page 35 - Disaster Recovery Planning—It is again recommended that the company perform and formally document annual review, updating, and testing of its disaster recovery plan.
6. Page 36 - Business Planning—It is recommended that the company engage in substantive business planning activities and that the company develop and adequately document a comprehensive strategic business plan.
7. Page 37 Capital Stock Disclosures—It is recommended that the company correctly report capital stock par values, and properly report capital and surplus balances using appropriate statutory annual statement convention captions, in compliance with NAIC Accounting Practices and Procedures Manual SSAP # 72.

## **X. ACKNOWLEDGMENT**

The courtesy and cooperation extended during the course of the examination by the officers and employees of the company are acknowledged.

In addition to the undersigned, the following representatives of the Office of the Commissioner of Insurance (OCI), State of Wisconsin, participated in the examination:

<b>Name</b>	<b>Title</b>
Sarah Haeft	Insurance Financial Examiner
Mark Knieval	Insurance Financial Examiner
Jean Suchomel	Insurance Financial Examiner
Randy Milquet	Advanced Financial Examiner

Respectfully submitted,

Thomas E. Rust  
Examiner-in-Charge